No. 89-1168

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

ESTATE OF NATHAN BOGRAD, J.B. KEIFER, EXECUTOR,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

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QUESTIONS PRESENTED

The questions presented are:

1. Whether the value of $160,000 of bearer Treasury notes that the decedent had purchased during his lifetime but were not found among the decedent's effects are properly includible in the gross estate for federal estate tax purposes.

2. Whether the settlement of a suit brought by a creditor of the estate is a deductible administrative expense for federal estate tax purposes.

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ESTATE OF NATHAN BOGRAD,
J.B. KIEFER, EXECUTOR,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioner, J.B. Kiefer, in his capacity as co-executor of the Estate of Dr. Nathan Bograd, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The unpublished opinion of the United States Court of Appeals for the Fifth Circuit is reprinted in the appendix to this petition at Pet. App. 1a. The opinion of the United States Tax Court is reported at T.C. Memo. 1988-34 and is reprinted in the appendix at Pet. App. 21a-35a.

JURISDICTION

The court of appeals entered its judgment on September 28, 1989 and denied the petition for rehearing on October 26, 1989. The jurisdiction of this Court is invoked under U.S.C. § 1254(1).

STATUTES INVOLVED

The statutory provisions involved in this case, Internal Revenue Code (26 U.S.C.) sections 2033 and 2035 (a)-(b), are as follows:

> § 2033. Property in which the decedent had an interest.
>
> The value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of his death.
>
> § 2035. Adjustments for gifts made within 3 years of decedent's death.[1]
>
> (a) **Inclusions of gifts made by decedent.** - Except as provided in subsection (b), the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a tran fer, by trust or otherwise, during the 3-year period ending on the date of the decedent's death.

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1. **Section 2035 was subsequently amended to provide that generally subsection (a) would not apply to the estate of a decedent dying after December 31, 1981. 26 U.S.C. § 2035(d).**

(b) **Exceptions.** - Subsection (a) shall not apply -

> (1) to any bona fide sale for an adequate and full consideration in money or money's worth. . . .

STATEMENT OF CASE

The Petition in this case arises out of the Commissioner of Internal Revenue's ("Commissioner") issuance to the Estate of Dr. Nathan Bograd (the "estate") a statutory notice of deficiency (the "deficiency notice") in federal estate tax. The tax court held that $160,000 in bearer Treasury notes over which the executor had no possession, custody or control are includible in the decedent's gross estate and that the amount paid in settlement of a lawsuit involving administration of estate property is not deductible as an administrative expense. The court of appeals affirmed the judgment of the tax court.

Dr. Nathan Bograd, a resident of Alabama, died testate on March 17, 1981. The probate court appointed J.B. Kiefer and Garnet Turner as co-executors of the estate.[2] A federal estate tax return was filed on behalf of the estate.

On December 7, 1984, the Commissioner issued the deficiency notice. The estate filed a petition with the tax court pursuant to 26 U.S.C. § 6213 seeking a redetermination of the tax deficiency. The case went to trial before Judge Whitaker of the United States Tax Court, on January

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2. **Although the will named J.B. Kiefer and Garnet Turner as co-executors, Petitioner J.B. Kiefer assumed all the responsibilities of administering the estate.**

22, 1987, on the merits of the following issues: (1) whether $160,000 in bearer Treasury notes that the decedent had purchased during his lifetime but were not found among his effects at his death should be included in the gross estate; and (2) whether the estate is entitled to a deduction as an administrative expense of the amount paid in settlement of a lawsuit against the co-executors of the estate. On February 1, 1988, Judge Whitaker rendered reasons, holding that the bearer Treasury notes are includible in the gross estate and that the amount paid to settle the lawsuit is not deductible as an administrative expense. The parties consented to the computation of the deficiency, and the tax court entered its judgment on June 22, 1988.

The court of appeals affirmed the judgment of the tax court on September 28, 1989 and denied the estate's petition for rehearing on October 26, 1989.

ARGUMENT

1. Whether the value of $160,000 of bearer Treasury notes that the decedent had purchased during his lifetime but were not found among the decedent's effects are includible in the gross estate for federal extate tax purposes.

During his later years, Dr. Bograd had purchased Treasury notes through his bank, Union Bank & Trust Company ("Union Bank").[3] The issue in this case involves seven bearer (coupon) Treasury notes (the "notes") with a total face value of $160,000 purchased from 1976-1981.

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3. At the time of Dr. Bograd's death, Union Bank held seven Treasury notes for Dr. Bograd in a safekeeping account. The value of those seven notes was included in the federal estate tax return, and there is no dispute regarding those notes.

Union Bank delivered five of the notes personally to Dr. Bograd. The executors did not find the notes in either Dr. Bograd's personal effects or in his safe deposit box, and accordingly they did not include the value of the notes in the federal estate tax return. In addition, Union Bank delivered two notes with total value of $60,000, purchased shortly before Dr. Bograd's death, to Ms. Coralee McDavid, a close friend of Dr. Bograd. Ms. McDavid testified at trial that she gave one of the notes[4] to Ms. Ann Kiefer, the decedent's sister, who denied receiving this note. Ms. McDavid testified that she put the other note[5] into her own safe deposit box.

The lower courts included $160,000 in the gross estate under Internal Revenue Code section 2033, which provides that the gross estate includes the value of property owned by the decedent at the time of his death, or alternatively under section 2035, which provides that the gross estate includes the value of property gratuitously transferred within three years prior to the decedent's death. The lower courts' inclusion of $160,000 in the gross estate is contrary to the evidence and should be reversed.

Ms. Kiefer testified without contradiction that Dr. Bograd gave her $70,000-$80,000 of the notes, in $10,000 and $20,000 denominations, in repayment of $50,000 of Ms. Kiefer's funds that Dr. Bograd had invested for her. Therefore, $70,000-$80,000 of the notes should not be included in the gross estate under either section 2033 because the decedent did not own the notes at the time of his death or under section 2035 because the transfer to Ms. Kiefer was not gratuitous.

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4. This note had a face value of $40,000.

5. This note had a face value of $20,000.

The tax court disregarded Ms. Kiefer's testimony about the family's investment procedures because, so it said, she could not recall specific details. Pet. App. 29a-30a. However, the only countervailing evidence was Ms. McDavid's testimony that she was not aware of Dr. Bograd's investing on behalf of his sister. It was an abuse of the tax court's discretion to disregard Ms. Kiefer's uncontradicted testimony.[6] The estate showed that $70,000-$80,000 of the notes were transferred to Ms. Kiefer for consideration and therefore should not be included in the gross estate.

The notes that the lower courts included in the gross estate also included one $5,000 note that had been purchased by Dr. Bograd in 1976, almost five years before his death. Despite a diligent search, the co-executors could not locate this note. Considering that the decedent purchased it almost five years before his death, it is likely that this note was transferred more than three years prior to death. Therefore, the value of this note should not be included in the gross estate under either section 2033 or section 2035.

The bearer notes also included a $20,000 note and a $40,000 note that Ms. McDavid received from Union Bank. Ms. McDavid testified that she then transmitted the $40,000 note to Ms. Kiefer; but Ms. Kiefer testified that she never received this note.

The trial court chose to believe Ms. McDavid despite the ill feelings toward Ms. Kiefer inherent in Ms. McDavid's testimony. After Ms. Kiefer testified that she had received $70,000-$80,000 of notes from Dr. Bograd, as reimbursement of funds invested, Ms. McDavid testified that she

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6. The trial court's assessments based on credibility are subject to being overturned if there was an abuse of discretion. *Theriot v. Bay Drilling Corp.*, 783 F.2d 527 (5th Cir. 1986).

refused to turn over the other note that she had received from the bank because "if [Dr. Bograd] couldn't give me a Treasury Note, he couldn't give [Ms. Kiefer] Treasury Notes." (McDavid, page 137.)

Ms. Kiefer had no reason to remove and retain estate assets. She was the beneficiary of Dr. Bograd's Keogh Account; she received various bank accounts as bequests; her children and grandchildren were beneficiaries of the testamentary trust; and she had already received $70,000-$80,000 as reimbursement for investments made for her by Dr. Bograd. Under these circumstances, it was an abuse of discretion to find that Ms. Kiefer had received the $40,000 note, instead of Ms. McDavid, who had the opportunity and motivation to retain the note.

The lower courts also included the $20,000 received by Ms. McDavid in the gross estate. There is no dispute that Ms. McDavid retained possession of the $20,000 note. The only dispute is the value to be included in the gross estate, which is discussed below.

In addition to the notes discussed above, $15,000-$25,000 of notes are unaccounted for. No witness testified that Dr. Bograd was in the habit of making gifts of large sums. The two most likely recipients of the notes are Ms. Kiefer and Ms. McDavid. The only testimony offered to show that Ms. Kiefer received these notes was Ms. McDavid's assertions (1) that Dr. Bograd said he wanted Ms. Kiefer to have the notes (McDavid, pages 156 and 157) and (2) that Ms. Kiefer had been told to go to the decedent's safe deposit box to retrieve the notes at the time of the decedent's death (McDavid, page 131).

There was no testimony that anyone witnessed Ms. Kiefer's retrieving the notes from Dr. Bograd's safe deposit box or having the notes in her possession. On the contrary, Ms. Kiefer testified that she never withdrew any notes from the decedent's safe deposit box. (Kiefer, page 57.) It is logical that Ms. McDavid received all notes not claimed by Ms. Kiefer.

If the notes held by Ms. McDavid, the $20,000 and $40,000 notes delivered to her by Union Bank plus the $15,000-$25,000 unaccounted-for notes, are includible in the gross estate, the value of those notes should be zero by virtue of the "Full Release of All Claims" (the "release") between Ms. McDavid and the estate, Trial Exhibit 5-E.[7] The release provided that Ms. McDavid would keep all the notes that were in her possession. Consequently, the estate would not have been able to receive any value for the notes that were in Ms. McDavid's possession; and the value for estate tax purposes is zero, the date of death value based on likelihood of collection. *See, e.g., Estate of I.W. Baldwin*, 18 T.C.M. 902, Dec. 23,818 (M), T.C. Memo 1959-203 and 20 T.C.M. 399, Dec. 24,741 (M), T.C. Memo 1961-89; *S.A. Levine*, 27 T.C.M. 284, Dec. 28,898 (M), T.C. Memo 1968-54; *Estate of T.O. Hamlin*, 9 T.C. 676, Dec. 16,061; *Gump v. Commissioner*, 124 F.2d 540 (9th Cir. 1942), *cert. den.*, 316 U.S. 697 (1942); *Mullikin v. Magruder*, 55 F. Supp. 895 (D. Md. 1944).[8]

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7. Alternatively, the notes held by Ms. McDavid should be deducted as an administrative expense. This argument is discussed below.

8. The United States Court of Appeals found that the estate could not raise the issue of valuation on appeal, citing *Wilson v. First National Bank*, 796 F.2d 752 (5th Cir. 1986). However, *Wilson* involved the proper valuation formula under the Bankruptcy Code, a statutory provision not at issue here.

In summary, the $160,000 of notes is accounted for as follows: Ms. Kiefer received $70,000-$80,000 of notes as reimbursement for funds advanced for investment; the $5,000 note purchased almost five years before the decedent's death, not found in the decedent's personal effects or safe deposit box, and was most likely transferred more than three years before the decedent's death; the $20,000 note that Ms. McDavid, undisputedly retained; the $40,000 note that Ms. McDavid received from Union Bank; and the other notes, valued at $15,000-$25,000, which by inference, testimony, and motivation were likely to have been retained by Ms. McDavid. The notes in Ms. McDavid's possession would be included in the gross estate at their value based on likelihood of collection, or zero. The $70,000-$80,000 of notes and the $5,000 are not includible under either section 2033 or 2035. Therefore, it was error to include the $160,000 of bearer (coupon) Treasury notes in the gross estate.

The lower courts' judgments impart a Kafkaesque quality to this estate. An executor who never had possession, custoday, or control of notes is required to pay federal estate tax on their value. How is this to be done? The assets are not available to the executor to pay the tax with, and the executor has no way to know to whom to look for reimbursement in seeking to apportion the tax. This gross inequity highlights a significant problem in the area of federal estate tax. In fairness, this Court should exercise its discretionary power and review this issue and in due course correct this gross inequity.

2. Whether the settlement of suit brought by a creditor of the estate for alleged administrative matters was a deductible administrative expense for federal estate tax purposes.

Dr. Bograd's will established a trust, which included his personal residence and its contents among its assets and

named J.B. Kiefer as trustee. The trust also provided that Ms. McDavid would have the use and occupancy of the house during her lifetime. The trust obligated Ms. McDavid to pay all taxes, insurance and repairs on the house up to a maximum of $500 per year and obligated the trustee to reimburse Ms. McDavid for any sums she expended for those expenses in excess of $500.

In 1982, Ms. McDavid spent $20,696 for taxes, insurance and repairs. When the trustee did not reimburse her, she sued Garnet Turner as co-executor of the estate and J.B. Kiefer as co-executor and as trustee. The lawsuit sought reimbursement for the sums expended in 1982 in excess of $500 as well as $500,000 in punitive damages and $1,200 in compensatory damages.[9]

The case was settled. The settlement agreement provided that Ms. McDavid would keep all the notes in her possession that belonged to the estate, which included at least the $20,000 note that Ms. McDavid had received from Union Bank, and would receive a cash payment of $15,000.

The estate claimed a deduction for any or all of the settlement to Ms. McDavid as an administrative expense under Internal Revenue Code section 2053. Treasury Regulation § 20.2053-3(a) allows a deduction for administrative expenses which are actually and necessarily incurred in the administration of the decedent's estate insofar as they "attend the settlement of an estate and the transfer of the property of the estate to . . . a trustee. . . ." Although the lower courts found that this payment was not deductible

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9. In addition to the claim for reimbursement, Ms. McDavid also alleged that the estate and trustee had willfully, wantonly and maliciously converted certain brass objects, for which she sought $1,200 in compensatory damages and $250,000 in punitive damages.

because it was a payment to a trust beneficiary, it is clear instead that Ms. McDavid sued the estate for reimbursement as a creditor and not as a trust beneficiary. This case is similar to a tort suit, which is deductible under Treasury Regulation § 20.2053-4, and to a claim paid in accordance with a bona fide agreement, which is deductible according to Revenue Ruling 76-542, 1976-2 C.B. 282.

In *Central Trust Co. v. Welch*, 304 F.2d 923 (6th Cir. 1962), the trustee of a testamentary trust was sued during the administration of the estate to set aside as invalid the trust for the decedent's daughter. The court held that the trustee's expenses to defend the trust, including the attorney's fees, were deductible on the federal estate tax return. Here, the estate was still under administration for tax purposes because the ultimate amount of trust corpus which would be received by the trust, as residuary legatee, depended on how much federal estate tax was payable from the residue of the estate. Although a probate court may send the heirs into possession of decedent's property, the administration is not truly concluded until the final determination of tax liability is made. *Cf. Meier v. Denver U.S. National Bank*, 431 P. 2d 1019 (Colo. 1967).

Accordingly, at least the $15,000 in cash paid to Ms. McDavid is a deductible expense of the estate. In addition, if the Treasury notes held by Ms. McDavid are included in the gross estate, the value of the notes retained by Ms. McDavid as part of the settlement should also be deducted as an administrative expense. Under the circumstances this Court should review the important issue for federal tax law to set forth guidelines for determining when settlements are deductible as administrative expenses.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 88-4707

ESTATE OF NATHAN BOGRAD, Deceased,
J.B. KIEFER, Executor,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Appeal from a Decision of the United States Tax Court

(September 28, 1989)

Before WISDOM, KING and WILLIAMS, Circuit Judges.

PER CURIAM:*

Appellants, Estate of Nathan Bograd and John B. Kiefer, co-executor, appeal from the tax court's determinations that (1) $160,000 in Treasury notes were includible in the decedent's gross estate, and (2) the Estate was not entitled to

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* Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burden on the legal profession." Pursuant to that Rule, the court has determined that this opinion should not be published.

deduct a $35,000 settlement on the terms of a testamentary trust as an administrative expense of the Estate. We affirm the tax court and hold that (1) the credibility determinations and factual findings made by the tax court that lead to its conclusion that $160,000 in Treasury notes should be includible in decedent's gross estate were not clearly erroneous, and (2) the settlement of a suit on the terms of a testamentary trust was a cost of the trust and not a deductible administrative expense of the Estate.

I.

Dr. Nathan Bograd ("Bograd") died testate on March 17, 1981. His nephew, John Kiefer, and his friend, Garnet Turner, were appointed co-executors. In December of 1984, the Commissioner of Internal Revenue issued to Bograd's estate a statutory notice of a deficiency in federal estate tax. The Estate filed a petition in tax court seeking a redetermination of the deficiency. The tax court sustained the assessment of the Commissioner of Internal Revenue and it is from that ruling that the executor appeals.

A. Treasury Notes

During Bograd's life, he purchased numerous Treasury notes, many of which he held in safekeeping at Union Bank & Trust Company ("Bank"). Those notes remaining in Bograd's safekeeping account at his death were duly reported on the Estate's federal estate tax return and are not at issue in this appeal.

Bograd also purchased several bearer (coupon) Treasury notes. These notes were not kept in his safekeeping account. The schedule for the bearer notes was as follows:

Amount	Bought	Description	Maturity
$ 5,000	8/16/76	Treasury Note 8% due	8/15/86
15,000	12/31/79	Treasury Note 11 3/8% due	12/31/81
10,000	8/15/79	Treasury Note 9% due	8/15/82
40,000	12/01/80	Treasury Note 13 7/8% due	11/30/82
30,000	12/31/80	Treasury Note 15 1/8% due	12/31/82
40,000	2/02/81	Treasury Note 13 5/8% due	1/31/83
20,000	3/02/81	Treasury Note 13 7/8% due	2/28/83
$160,000			

Those bearer notes purchased before 1981 were delivered to Bograd personally and he generally kept those notes in his safe deposit box. Only Bograd and his sister, Ann Kiefer ("Ms. Kiefer"), had access to the safe deposit box.

With Bograd's authorization, the two notes purchased in 1981 were delivered to his close personal friend Coralie McDavid ("McDavid"). The $40,000 note was delivered to McDavid the day before Bograd's death, and McDavid delivered the note to Ms. Kiefer the following day.[1] Pursuant to Bograd's earlier instructions, the $20,000 note was delivered to McDavid shortly after its arrival at the Bank but nearly

1. At trial, Ms. Kiefer contended that she never received the $40,000 note. She further alleged that Bograd had given her $70,000-$80,000 in Treasury notes as repayment for $50,000 she had given Bograd to invest in stocks. For reasons discussed below, the tax court disregarded her testimony.

one month after Bograd's death. This note had been purchased by McDavid with a check Bograd had drawn on another bank. McDavid kept this note in her safe deposit box.

At Bograd's death, none of the $160,000 in bearer notes was found in his personal effects or his safe deposit box. These notes were not included on the estate's federal estate tax return. In the statutory notice received by the Estate, the Commissioner determined that these notes were part of the gross estate and increased the taxable estate by $160,000.

The tax court found that the $40,000 note had been delivered to Kiefer and was, therefore, includible in the gross estate under I.R.C. § 2035(a).[2] The court further held that the proceeds used to purchase the $20,000 note held by McDavid were includible under I.R.C. § 2033.[3] Finally, the court held that the Estate had failed to meet its burden of proving that the remaining $100,000 in notes were not includible in the gross estate under I.R.C. § 2033.[4]

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2. The tax court found that the $40,000 note was a gift made within three years of death and, thus, includible in the Estate under I.R.C. § 2035(a).

3. The tax court held that the proceeds with which the $20,000 note was purchased were includible as property in which the decedent had an interest at death under I.R.C. § 2033.

4. The Commissioner's determination that the remaining notes were includible in the Estate creates a presumption to that effect. Rules of Practice and Procedure of United States Tax Court § 142(a). The tax court held that the Estate failed to rebut that presumption in favor of the Commissioner.

B. Settlement on House Repairs

Bograd's will contained a residuary clause creating a testamentary trust with John Kiefer ("Mr. Kiefer") as trustee and McDavid as beneficiary. Mr. Kiefer also served as co-executor of Bograd's estate. The relevant portion of the trust provided:

> C. During the term of her life, I hereby authorize and direct my Trustee to allow, make available and provide the use and occupancy of my home located on Hillwood Drive to Coralie McDavid. During such time the following circumstances and conditions will govern and control Coralie McDavid's use and occupancy of said home:
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> > 1. Coralie McDavid shall pay all taxes, insurance and repairs on said home up to a maximum of Five Hundred ($500.00) Dollars per year; and, in the event that Coralie McDavid is called upon to pay any sum in excess of Five Hundred ($500.00) Dollars per year for such taxes, insurance and repairs, the Trustee is hereby authorized and directed to reimburse her for such sum in excess of Five Hundred ($500.00) Dollars.

McDavid lived in Bograd's house after his death in accordance with the terms of the trust. Upon discovering that repairs to the foundation of the house were needed, she

contacted Garnet Turner (co-executor of the estate).[5] Turner advised Mr. Kiefer of the need for repairs. McDavid repaired the house in 1982 after some further consultation with Turner. For the year 1982, taxes, insurance and repairs totaled $20,696.04.

McDavid sought reimbursement from Mr. Kiefer pursuant to the terms of the testamentary trust. By the year 1985, McDavid had still not received reimbursement. Seeking payment, she filed suit in the Circuit Court of Montgomery County, Alabama. She named as defendants John Kiefer, in his capacity as co-executor of Bograd's estate and in his capacity as trustee of the Bograd trust, and Garnet Turner in his capacity as co-executor of the Estate. McDavid alleged that the co-executors and trustee willfully, maliciously and without good cause, failed to reimburse her for the repair expenses she incurred. She sought $20,696.04 in compensatory damages and $250,000 in punitive damages.[6]

Later in 1985, the parties agreed to settle the matter.[7] McDavid executed a "Limited Release of All Claims" whereby she released her claims in consideration for a sum of $15,000. In his capacities as co-executor and trustee, Mr. Kiefer executed another "Limited Release of All Claims" whereby, in consideration for $1.00 and the dismissal with prejudice of McDavid's suit, he released: "Any claim for

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5. Apparently, Turner was contacted because he was familiar with the house, although the testimony was unclear as to whether McDavid contacted Turner in his official capacity as co-executor.

6. In Count Two of McDavid's complaint, she also sought $1,200 compensatory damages and $250,000 punitive damages for conversion of certain brass objects.

7. At the time the parties settled the suit, the estate remained open.

negotiable instruments, treasury bills, treasury notes, . . . which belong to Nathan Bograd or the Nathan Bograd estate or the Nathan Bograd trust."[8]

At the tax court, a dispute arose over the deductibility of the settlement amount. The Commissioner and the Estate contested whether payments made for the settlement of McDavid's claim[9] were deductible as an expense in the administration of the estate pursuant to I.R.C. § 2053.[10]

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8. This second release agreement essentially entitled McDavid to the $20,000 Treasury note delivered to her and not returned to the estate.

9. The settlement totalled $35,000—$15,000 under the first release and $20,000 for the Treasury note retained by McDavid under the second release. The estate was unable to present evidence regarding attorneys' fees expended as a result of McDavid's suit. Therefore, the estate does not claim a deduction for any such sum.

10. Section 2053 allows for deduction of certain costs from the gross estate. In relevant part, that section provides:

> (a) General rule. - For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate such amounts—
>
> (1) for funeral expenses,
> (2) for administration expenses,
> (3) for claims against the estate, and
> (4) for unpaid mortgages on, or any indebtedness in respect of, property where the value of the decedent's interest therein, undiminished by such mortgage or indebtedness, is included in the value of the gross estate,
>
> as are allowed by the laws of the jurisdiction, whether within or without the United States, under which the estate is being administered. . . .

The tax court held that the cost of settling McDavid's claim did not constitute an "administration expense" of the Estate within the meaning of the Internal Revenue Code.

II.

In the Estate's first claim of error, it contends that the tax court's holding that the $160,000 in Treasury notes were part of Bograd's estate is clearly erroneous because the tax court chose to believe a less credible witness and misconstrued the evidence.

Factual findings of the tax court are subject to the clearly erroneous standard.[11] *Anderson v. Bessemer City*, 470 U.S. 564, 573-76 (1985); *Commissioner v. Duberstein*, 363 U.S. 278, 291 (1960). The trial court is entitled to great deference where, as here, credibility issues are determinative. Fed. R. Civ. P. 52(a) ("due regard shall be given to the opportunity of the trial court to judge the credibility of witnesses"). This is true because "only the trial judge can be aware of the variations of demeanor and tone of voice that bear so heavily on the listener's understanding of and belief in what is said." *Anderson*, 470 U.S. at 575. In general, where a trial judge's finding is based on a choice to credit one witness' testimony over another, there "can virtually never be clear error." *Id.*

At trial, contradictory testimony was presented by Ann Kiefer and Coralie McDavid regarding the delivery of the $40,000 note. Ms. Kiefer testified that McDavid had not delivered the note to her, while McDavid testified that she had. The tax court found Kiefer's testimony to be "clouded

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11. In addition, we note that the Commissioner's determination is presumed to be correct and the Estate must disprove it. Rules of Practice and Procedure of United States Tax Court 142(a); *see also United States v. Janis*, 428 U.S. 433, 440-41 (1976).

with uncertainty [and] simply unbelievable" while McDavid's explanation of the events was "cogent and consistent.[12] The tax court's decision to regard McDavid's testimony on this issue as more credible than Kiefer's is supported by the record and is not clearly erroneous.

Ms. Kiefer also testified that Bograd had given her $70,000-$80,000 in notes as repayment for $50,000 she had given him to invest in the stock market. The tax court found this testimony to be vague, internally inconsistent and contradicted by circumstantial evidence. Thus, it decided to "completely disregard" Ms. Kiefer's testimony.[13] The Estate is baffled by the court's credibility determinations. However, the tax court's logical dissection of the vagaries and inconsistencies of Ms. Kiefer's testimony leads us to hold that its

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12. The court also found that much of McDavid's testimony was "corroberated by independent evidence such as letters or bank records as well as the testimony of Ms. Cannon, the bank's vice-president."

13. The tax court carefully analyzed the evidence, finding:

> Ms. Keifer's [sic] testimony at trial about these events was vague at best. Her failure to recollect any details with respect to these events has lead us to completely disregard her testimony. She could not recall any details about the investments allegedly made by her brother on her behalf, and had no records indicating the amounts she gave him or dates she advanced money to him. She reported no gain from the investments and failed to recollect receiving income from the companies in which her brother allegedly invested. She also did not remember when she received the notes from her brother.

credibility determination was not clearly erroneous.[14] *See Bose Corp. v. Consumers Union*, 466 U.S. 485, 512 (1984).

III.

The Estate's second claim of error challenges the tax court's holding that the $35,000 settlement of McDavid's suit for repairs under the terms of the Bograd testamentary trust was not deductible as an administrative expense of the Estate under I.R.C. § 2053. The Estate first contends that the entire $35,000 settlement was an administrative expense of the Estate because the Estate was a party to the settlement. In the alternative, the Estate maintains that the amount of the settlement in excess of actual costs under the terms of the trust is deductible as an administrative expense

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14. In passing, the Estate raises a variety of subsidiary issues with minimal elaboration.

The Estate contends that the $5,000 note was transferred more than three years before Bograd's death, and thus, not part of the gross estate. However, no evidence was presented to this effect and the Commissioner's determination that the note was part of the Estate is presumptively correct. Thus, we hold that this note was part of the Estate under I.R.C. § 2033.

Next, the Estate contends that notes should be valued at an "at death" value rather than face value. However, as the tax court noted, the issue of the value of Treasury notes was not raised by the Estate. Only purely legal issues may be raised for the first time on appeal. *Northern Miss. Communications v. Jones*, 874 F.2d 1064, 1068 (5th Cir. 1989). However, valuation is a mixed question of law and fact. *Matter of Missionary Baptist Found. of Am.*, 796 F.2d 752, 760-61 (5th Cir. 1986). Thus, this challenge was lost at the tax court.

The Estate further contends that because of a release executed in favor of the Estate, the notes should be valued at zero. This is also a valuation question that was waived by the Estate.

of the Estate. The Commissioner retorts that the settlement was for a claim against the trust and not an administrative expense of the Estate and, therefore, not deductible under § 2053. We review the factual determinations necessary to the tax court's holding under the "clearly erroneous" standard, while the ultimate question of the deductibility of a settlement as an administrative expense of the Estate is a question of law subject to de novo review.

Expenses that fall within the Code's definition of "administrative expenses" under § 2053(a)(2) and are allowable under state law[15] are deductible from a decedent's gross estate. *Pitner v. United States*, 388 F.2d 651, 659 (5th Cir. 1967). The Treasury Regulations on estate law provide the meat for the skeleton of § 2053. The regulations provide:

> The amounts deductible from a decedent's gross estate as "administration expenses" are limited to such expenses as are actually and necessarily, incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the

15. **We do not reach the issue of whether McDavid's settlement is an administrative expense allowable under state law because we hold that this settlement was not an administrative expense of the Estate as defined by § 2053(a)(2) and its attendant regulations.**

> heirs, legatees, or devisees, may not be taken as deductions. Administration expenses include (1) executor's commissions: (2) attorney's fees and (3) miscellaneous expenses. . . .

Treas. Reg. § 20-2053-3(a) (as amended in 1979). The regulations elaborate upon "miscellaneous administrative expenses".

> Miscellaneous administration expenses include such expenses as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in preserving and distributing the estate are deductible, including the cost of storing or maintaining property of the estate, if it is impossible to effect immediate distribution to the beneficiaries. Expenses for perserving and caring for the property may not include outlays for additions or improvements; nor will such expenses be allowed for a longer period than the executor is reasonably required to retain the property. . . .

Treas. Reg. § 20.2053-3(d)(1) (as amended in 1979).

Assuming that this settlement may be an "administration expense" under § 2053(a)(2),[16] the inquiry turns to whether

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16 We assume, without deciding, that a settlement may constitute an "administrative expense" under § 2053(a)(2) and its attendant regulations. However, as discussed below, we conclude that even if a settlement could constitute an administrative expense in some context, the settlement at issue here is an expense of the residuary trust, not Bograd's estate. *See Pennsylvania Bank & Trust v. United States*, 597 F.2d 382, 384 (3d Cir.). *cert. denied*, 444 U.S. 980 (1979) (settlement payment to avoid "nuisance" suit not deductible as administrative expense).

the settlement was an expense of administering the *trust* or an expense of administering the *estate*. Was the cost of settling McDavid's suit an expense to the trust or to the Estate?[17] Payments made to a beneficiary in settlement of a claim against an estate are not deductible. *Estate of Lazar v. Commissioner*, 58 T.C. 543 (1972). The Estate alleges, however, that McDavid settled the suit here as a "creditor" and not as "beneficiary."[18]

We agree with the tax court that *Central Trust Co. of Cincinnati v. Welch*, 304 F.2d 923 (6th Cir. 1962), draws an appropriate line, for our purposes, between an administration expense of a trust and an administration expense of an estate. In that case, a dispute arose over the validity of an intervivos trust created by the decedent. If the trust were set aside, the property in the trust would have become part of the estate instead of passing outside the estate. The estate sought to deduct certain costs of the trustee's suit regarding the validity of the trust as an administrative expense of the estate. The Sixth Circuit held that the costs

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17. The tax court found, based upon the limited record before it of the prior suit and settlement, that McDavid was merely "permitted to keep" the $20,000 Treasury note as part of the consideration for dismissing her claim on the terms of the trust. By inference, the tax court concluded that no significant dispute regarding the ownership of the Treasury notes arose during the suit and settlement for repairs under the terms of the trust. This factual determination regarding the nature and impetus for the settlement agreement is not clearly erroneous.

18. As the tax court noted, the Estate does not contend that McDavid's settlement was deductible as a "claim against the estate" under I.R.C. § 2053(a)(3). The Estate's forbearance appears to rest on the assumption that McDavid's claim did not exist "at the time of [Bograd's] death" as required by Treas. Reg. § 20-2053-4. Somewhat anomalously, the Estate maintains that McDavid sued as a "creditor" and not as a "beneficiary."

were deductible in that case because the suit was necessary "to determine what property was to be included in the . . . estate" for estate tax purposes. *Id.* at 928.[19]

In the instant case, there was no dispute about the includibility of the trust in the estate. The action out of which this settlement arose was a dispute over enforcement of the trust, not a dispute over what property was to be included in the Estate.[20] The wheels of the Bograd trust had not just begun to turn; rather, the Bograd trust had been rolling for approximately four years at the time of the settlement. Thus, we agree with the tax court that the cost of settling McDavid's claim for repairs under the terms of the trust was not an administrative expense of the estate.[21] *See Estate of Streeter v. Commissioner*, 491 F.2d 375, 380 (3d Cir. 1974) (en banc) ("where the trust property involved was essentially testamentary disposition, the courts recognized that distribution by the executor completed administration of the probate estate for purposes of the estate tax administrative expense deduction").

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19. The line drawn is in keeping with the Treasury Regulations on estate law which limit the administrative expenses deduction to those "expenditures . . . essential to the proper settlement of the estate. . . ." Treas. Reg. § 20-2053-3(a). *See also Estate of Carson v. Commissioner*, 35 T.C.M. (CCH) 330 (1976) ("to be classified as administration expenses, expenditures must relate to the winding up of the decedent's affairs, that is, to the disposition of his property, whether it be to creditors or beneficiaries").

20. We recognize that the size of the Estate will be affected by the deductibility of the settlement. However, the question of whether the *trust was includible in the estate* was not disputed in the action out of which this settlement arose.

21. Indeed, the suit for repairs under the terms of the trust might well have occurred long after the Estate was closed. It would be a strange result indeed for us to conclude that the settlement of McDavid's suit upon the terms of the trust is a cost to the Estate merely because the Estate happens to remain open.

The Estate makes much of the fact that the settlement agreement in McDavid's suit was signed by Mr. Kiefer in both his capacity as trustee and co-executor. Apparently, the Estate believes that Kiefer's signing the settlement in his capacity as co-executor changes the character of the suit from an action against the trust to an action against the estate. The tax court determined that Mr. Kiefer signed the McDavid settlement agreement as trustee not as co-executor. Because the subject matter of the suit was, at bottom, the terms of the trust, the tax court's determination that Kiefer signed the settlement as trustee was not clearly erroneous. Therefore, the settlement is not an administrative expense of the estate.[22] *See Pennsylvania Bank & Trust v. United States*, 597 F.2d 382, 384 (3d Cir.), *cert. denied*, 444 U.S. 980 (1979) ("status of claimant is [often] the determinative factor" in determining deductibility of administrative expenses).

Merely because an estate is technically open, it cannot be said that any cost bearing some tangential relation to the estate can be an administrative expense of the estate—to so hold would emphasize form over substance. The settlement at issue arose out of a dispute over enforcement of the terms of a trust. That settlement concerned the Bograd trust, not the Bograd estate. Therefore, we conclude that the cost of the settlement of McDavid's suit cannot be considered an administrative expense of the Estate under I.R.C. § 2053 (a)(2).

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22. The tax court concluded that the settlement in toto involved the trust, not the Estate. The tax court therefore properly rejected the Estate's alternative contention that the excess of the settlement over costs of repairs can be considered an administrative expense.

IV.

For all the foregoing reasons, we AFFIRM the judgment of the tax court.

APPENDIX B

UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 88-4707

Tax Court Docket No. 4417-85

ESTATE OF NATHAN BOGRAD, Deceased,
J. B. KEIFER, Executor,
Petitioner-Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

U. S. COURT OF APPEALS
FILED
SEP 28 1989
GILBERT F. GANUCHEAU
CLERK
(stamp)

Appeal from the Decision of the United States Tax Court

Before WISDOM, KING, and WILLIAM, Circuit Judges.

JUDGMENT

This cause came on to be heard on the record on appeal of the United States Tax Court and was taken under submission on the briefs on file.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the Tax Court in this cause is affirmed.

IT IS FURTHER ORDERED that petitioner-appellant pay to respondent-appellee the costs on appeal, to be taxed by the Clerk of this Court.

September 28, 1989

ISSUED AS MANDATE: **NOV 6 1989**
(stamp)

APPENDIX C

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

No. 88-4707

ESTATE OF NATHAN BOGRAD, Deceased,
J.B. KIEFER, Executor,
Petitioner-Appellant,

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

COURT OF APPEALS
F I L E D
OCT 26 1989
GILBERT F. GANUCHEAU
CLERK
(stamp)

Appeal from the United States Tax Court

ON PETITION FOR REHEARING
(OCTOBER 26, 1989)

Before WISDOM, KING and WILLIAMS, Circuit Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing filed in the above entitled and numbered cause be and the same is hereby denied.

ENTERED FOR THE COURT:

s/s Carolyn D. King
United States Circuit Judge

CLERK'S NOTE:
SEE FRAP AND LOCAL RULES 41 FOR STAY OF THE MANDATE.
(stamp)

APPENDIX D

T. C. Memo. 1988-34

UNITED STATES TAX COURT

ADM.
RECORDED
s/s BR
SERVICE
s/s BR
CAL.
(illegible)
JUDGE
s/s Whitaker
FILES
(stamp)

ESTATE OF NATHAN BOGRAD, DECEASED, J. B. KEIFER, EXECUTOR, Petitioner *v.* COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 4417-85. Filed February 1, 1988.

Held: Petitioner failed to prove that the taxable estate does not include the value of bearer notes purchased by decedent before his death; *held further*, petitioner is not entitled to a deduction for payments in settlement of claims of beneficiary of testamentary trust.

Bruce A. Miller, for the petitioner.
Linda K. West, for the respondent.

SERVED FEB 1 1988
(stamp)

MEMORANDUM FINDINGS OF FACT AND OPINION

WHITAKER, *Judge:* Respondent issued a notice of deficiency on December 7, 1984, having determined a deficiency in the estate tax liability of the Estate of Nathan Bograd (petitioner) in the amount of $97,201.58. After concessions, the issues for decision are:

(1) Whether bearer Treasury notes totaling $160,000 should be included in the taxable estate; and

(2) whether the estate is entitled to a deduction for administrative expenses in the amount of $35,000.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. Nathan Bograd (Dr. Bograd), decedent, died testate March 17, 1981. He was a resident of Montgomery, Alabama. His nephew, John B. Keifer, and his friend, Garnet Turner, were appointed to serve as co-executors of his estate. Letters Testamentary were granted to Mr. Keifer and Mr. Turner by the Probate Court of Montgomery County, Alabama, on May 6, 1981, the same day the Probate Court admitted decedent's will to probate. At the time the petition in this case was filed, John B. Keifer resided in New Orleans, Louisiana.

Treasury Notes

During his life, Dr. Bograd purchased Treasury notes through Union Bank & Trust Company (Union Bank) in Montgomery, Alabama. The following securities were held

in safekeeping by the bank and were reported on Schedule C of the estate tax return filed by the petitioner:

Amount	Bought	Description	Maturity
$ 5,000	04/09/79	Treasury Note 9 5/8% due	03/31/81
5,000	04/30/79	Treasury Note 9 3/4% due	04/30/81
5,000	02/15/78	Treasury Note 7 1/2% due	05/15/81
5,000	07/02/79	Treasury Note 9 1/8% due	06/30/81
45,000	07/09/76	Treasury Note 7 5/8% due	08/15/81
10,000	10/31/79	Treasury Note 12 5/8% due	10/31/81
4,000	01/02/79	Treasury Note 9 3/8% due	12/31/82

Interest on these securities was paid semiannually by Union Bank.

Dr. Bograd also purchased bearer (coupon) Treasury notes through Union Bank that were not held in safekeeping by the bank. These notes, listed below, were not included in the estate tax return, and they were not found by the executors of the estate in Dr. Bograd's personal effects or his Union Bank safe deposit box which was located at the Eastbrook branch:[1]

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1. No record of the serial numbers of the bearer notes listed above exists. The name of the owner of a bearer note is not printed on its face and no record of its ownership is maintained by the Bureau of Public Debt. Title of a bearer note passes by delivery from one owner to another without notice to the Bureau. If furnished with a complete description of a bearer note, which includes the issue title with rate of interest, issue and maturity dates, serial number and denomination, the Bureau of Public Debt's records would show if the particular bearer note is open or closed. If the note is closed, the Bureau would normally be able to furnish only the date it was received in the Department of the Treasury and the name of the Federal Reserve Bank or Branch that submitted the note. The Bureau would not be able to provide any information as to whom payment of the retired note was made if the note was redeemed, nor would the Bureau be able to determine who the owner of the note had been.

Amount	Bought	Description	Maturity
$15,000	12/31/79	Treasury Note 11 3/8% due	12/31/81
10,000	08/15/79	Treasury Note 9% due	08/15/82
40,000	12/01/80	Treasury Note 13 7/8% due	11/30/82
30,000	12/31/80	Treasury Note 15 1/8% due	12/31/82
40,000	02/02/81	Treasury Note 13 5/8% due	01/31/83
20,000	03/02/81	Treasury Note 13 7/8% due	02/28/83
5,000	08/16/76	Treasury Note 8% due	08/15/86

Of these bearer notes, those purchased before 1981 were delivered by a representative of Union Bank to Dr. Bograd personally. He generally kept the notes in his safe deposit box located at the Eastbrook branch of Union Bank. Dr. Bograd and his sister, Ann Keifer, were the only individuals with access to this box.

The two notes purchased in 1981, shortly before Dr. Bograd's death, were delivered by a representative of the bank to Coralie McDavid, a close friend to whom Dr. Bograd had authorized delivery. Jane Cannon, Assistant Vice-President of the investment department of Union Bank in Montgomery, kept records of the dates the bearer notes were received and delivered by the bank. The $40,000 note arrived on March 10, 1981. A representative of the bank delivered the note to Ms. McDavid on March 16, 1981, the day before the decedent's death. The $20,000 note arrived at the bank April 13, 1981. Ms. Cannon, who usually handled the delivery of the notes on behalf of the bank, was out of town when the note arrived and was unaware of Dr. Bograd's death. She phoned authorization for the release of the note pursuant to prior instructions of Dr. Bograd and Ms. McDavid picked up the note on April 16, 1981. Usually Ms. Cannon debited Dr. Bograd's account when he purchased a Treasury note, however Ms. McDavid purchased this note with a check she had received from Dr. Bograd drawn on another bank.

Ms. McDavid delivered the $40,000 note to Dr. Bograd's sister the same day she picked it up from the bank.[2] Upon receipt of the second note, Ms. McDavid put it in her own safe deposit box.

In the statutory notice respondent determined that Dr. Bograd owned all of the bearer notes on the date of his death, that the notes were part of the gross estate, and that on the alternate valuation date their fair market value was $160,000. Accordingly, respondent increased the value of the taxable estate by $160,000.

Expenses of the Estate

In his Last Will and Testament decedent made various specific bequests of property, none of which included the bearer notes discussed above. The rest, residue, and remainder of his property was bequeathed to John B. Keifer as trustee of a testamentary trust to be known as the "Nathan Bograd Trust." The terms and conditions of the trust included the following:

> C. During the term of her life, I hereby authorize and direct my Trustee to allow,

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2. Ms. Keifer did not recall having received the $40,000 note from Ms. McDavid and further alleged that prior to his death, Dr. Bograd had given her $70-80,000 in Treasury notes in repayment of $50,000 she had given him to invest in the stock market for her. Ms. Keifer's testimony at trial about these events was vague at best. Her failure to recollect any details with respect to these events has lead us to completely disregard her testimony. She could not recall any details about the investments allegedly made by her brother on her behalf, and had no records indicating the amounts she gave him or dates she advanced monies to him. She reported no gain from the investments and failed to recollect receiving any forms reporting dividend income from the companies in which her brother allegedly invested. She also did not remember when she received the notes from her brother.

make available and provide the use and occupancy of my home located on Hillwood Drive to Coralie McDavid. During such time the following circumstances and conditions will govern and control Coralie McDavid's use and occupancy of said home:

> 1. Coralie McDavid shall pay all taxes, insurance and repairs on said home up to a maximum of Five Hundred ($500.00) Dollars per year; and, in the event that Coralie McDavid is called upon to pay any sum in excess of Five Hundred ($500.00) Dollars per year for such taxes, insurance and repairs, the Trustee is hereby authorized and directed to reimburse her for such sum in excess of Five Hundred ($500.00) Dollars.

* * *

Ms. McDavid resided in Dr. Bograd's house after his death. Upon discovering that repairs to the house were needed, she contacted Garnet Turner. He inspected the house, had a structural engineer examine it, and then had contractors bid on the repair job. Mr. Turner also advised Mr. Keifer that repairs were necessary to preserve the property value.

During the year 1982, Ms. McDavid expended a total of $20,696.04 for taxes, insurance, and repairs to the house. She sought reimbursement from Mr. Keifer, as Trustee, pursuant to the terms of the testamentary trust. In April

1985, when it appeared that reimbursement would not be forthcoming, Ms. McDavid filed a Complaint in the Circuit Court of Montgomery County, Alabama, naming as defendants John B. Keifer, as Co-Executor of the Estate of Nathan Bograd, Deceased, and as Trustee of the Nathan Bograd Trust; and Garnet Turner, as Co-Executor of the Estate of Nathan Bograd, Deceased. Ms. McDavid averred that Mr. Keifer, as Co-Executor and Trustee, failed to reimburse her for payments she made and that his actions were willful, malicious, and without good cause. Ms. McDavid sought relief of $20,696.04 compensatory damages and $250,000 punitive damages. Court II of the Complaint charged the estate and the trustee with willfully, wantonly, and maliciously converting certain brass objects. Ms. McDavid sought compensatory damages of $1,200 and punitive damages of $250,000 with respect to this charge.

The parties agreed to settle the dispute later that year. Ms. McDavid executed a Limited Release of All Claims whereby, in consideration of the sum of $15,000, she released all claims she may have had for payment of the repair bill and for failure of the estate or the Trustee to deliver the brass objects. Mr. Keifer executed a Full Release of All Claims whereby, in consideration of $1.00 and dismissal with prejudice of Ms. McDavid's lawsuit, he released all claims against her relating to the lawsuit, and specifically released "Any claim for negotiable instruments, treasury bills treasury notes, or any other assets, tangible or intangible personal, real or chosen action which belong to or may have belonged to Nathan Bograd or the Nathan Bograd estate or the Nathan Bograd trust."

A deduction in the amount of $35,000 was claimed on the estate tax return for attorney and executor's fees. In the statutory notice respondent determined that only $17,500 was paid and therefore allowable. At trial the parties stipulated that the estate was entitled to a deduction for attorney,

executor, and accountant's fees in the amount of $37,010, rather than $17,500 as determined in the statutory notice. However the amount agreed upon did not include any payment in settlement of Ms. McDavid's claim. Respondent contends that the payment made to settle the lawsuit is not deductible.

OPINION

Issue 1

We note initially that petitioner bears the burden of proving that respondent's determinations are incorrect. Rule 142(a). Petitioner contends that the value of the taxable estate should not be increased by $160,000 because some of the notes which respondent determined to be part of the estate were given to Ms. Keifer by decedent as a return on the $50,000 investment decedent made for her. The remaining notes, petitioner maintains, were delivered to Ms. McDavid without valid authorization therefore were not transferred by decedent.[3]

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3. Petitioner's argument with respect to the notes delivered to Ms. McDavid is not entirely clear. As we understand it petitioner admits that Ms. McDavid received the notes, but claims that she did not have valid authorization to receive them and that they were not intended to be gifts to her. Petitioner then concludes that if the notes were not gifts, the property was not transferred by the decedent, and therefore would not be includable by reason of section 2035. It appears, however, that this conclusion omits consideration that the amounts would be includable under section 2033 since, under petitioner's theory, Ms. McDavid did not have rightful claim to the notes, but the estate did. We have concluded on the facts presented that Ms. McDavid was authorized to receive the $40,000 and $20,000 notes, and that she did so on behalf of the decedent. Therefore we have not addressed the issue as it has been framed by petitioner.

On the record before us petitioner's arguments are unfounded. Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of decedent's interest therein at the time of death. The value of the gross estate also includes the value of any interest in property which decedent transferred, by trust or otherwise, within the 3-year period prior to decedent's death. Sec. 2035(a).[4] If decedent received full and adequate consideration for the property transferred, or upon transfer of the property decedent was not required by section 6019 to file a gift tax return with respect to the transfer, section 2035(a) does not apply. Sec. 2035(b).

In this case petitioner has not proven that the notes were not owned by Dr. Bograd when he died, or that they should not be included in his taxable estate for any other reason. With the exception of the last two notes purchased, whereabounts of which were explained by Ms. McDavid, there is no indication that the notes were disposed of by Dr. Bograd before he died, by gift or otherwise. The location of and therefore possessory interest in $100,000 of the notes is simply unexplained. The only evidence petitioner presented was Ms. Keifer's testimony that Dr. Bograd gave her $70-80,000 of the notes in repayment of $50,000 she had given him to invest in the stock market. However we have completely disregarded this testimony because of the failure of Ms. Keifer to recollect any of the details pertaining to the alleged investments or the receipt of the notes. We are not required to take into account evidence that is clouded with uncertainty or simply unbelievable and have not done so here. *Bose Corp. v. Consumers Union of U.S., Inc.*, 466 U.S. 485, 512 (1984).

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4. With certain exceptions, section 2035(a) does not apply to the estate of a decedent dying after December 31, 1981. Sec. 2035(d)(1).

In contrast to Ms. Keifer, we found Ms. McDavid to be a credible witness. Her explanation of the events that took place was cogent and consistent and much of her testimony was corroborated by independent evidence such as letters or bank records as well as the testimony of Ms. Cannon, the bank's vicepresident. Ms. McDavid testified that she was aware of Dr. Bograd's personal and financial affairs and knew of no investing that he had done on behalf of or in connection with his sister. She also testified that Dr. Bograd generally kept Treasury notes in his safe deposit box and that she had accompanied him personally to the bank on several occasions when he clipped coupons from the notes. This is the only evidence of the possible whereabouts of the notes after they were delivered to Dr. Bograd.[5]

Based on Ms. McDavid's testimony we have found as fact that she delivered the $40,000 note to Ms. Keifer and kept the additional $20,000 note in safekeeping. However, as stated above, we are unable to determine what happened to the remaining notes. On these facts we hold that the value of the $40,000 note given to Ms. Kiefer is includable in decedent's gross estate pursuant to section 2035(a), and the value of the $20,000 note, held in safekeeping by Ms. McDavid is includable in decedent's gross estate pursuant to

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5. Ms. McDavid speculated, probably with good reason, that Ms. Keifer removed the notes from the safe deposit box at the direction of Dr. Bograd either before or shortly after his death. Ms. McDavid testified that Dr. Bograd indicated that although his sister was not a beneficiary under his will, she would be taken care of. Under these circumstances, and given the vagueness of Ms. Keifer's testimony, it is entirely possible that Dr. Bograd directed his sister to remove the notes from the safe deposit box to avoid any estate tax liability for them.

2033(a).[6] The remaining notes, not proven to have been disposed of otherwise, are presumed to be a part of decedent's estate. Based on the above, the value of the taxable estate should be increased by the value of the notes, or $160,000.[7]

Issue 2

Petitioner also contends that the estate is entitled to a deduction in the amount of $35,000 because the settlement of the lawsuit by Ms. McDavid against the estate and trust is an expense of administration.[8] In maintaining this position, petitioner claims that Ms. McDavid was a creditor of the estate[9] rather than a beneficiary because she received more

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6. We recognize that delivery of the $20,000 note did not take place until after Dr. Bograd's death, and that therefore the note itself was not a part of the estate. However, the proceeds with which the note was purchased would be includible in the value of the estate and the result under these circumstances would be the same. Because the parties argued on the basis of the note's includability we have referred to it rather than to the proceeds used to purchase the note.

7. In the statutory notice respondent determined that on the alternate valuation date the fair market value of the notes equaled their face value. Petitioner has not challenged the value of the notes, therefore we have sustained respondent's determination.

8. Petitioner claims that the entire $35,000 is deductible only in the event that we determine, which we have, that the $20,000 note which Ms. McDavid was permitted to keep was includable in the taxable estate.

9. Petitioner does not argue that the amount should be deductible as a "claim against the estate." See sec. 2053(a)(3) and sec. 20.2053-4, Estate Tax Regs. Claims against the estate "represent personal obligations of the decedent existing at the time of his death, whether or not then matured * * *" (sec. 20.2053-4, Estate Tax Regs.), and petitioner acknowledges that the value of a beneficiary's distributive

in the settlement than the cost of the repairs and because she named the trustee and co-executors as defendants in her suit to recover amounts paid to repair the house. Alternatively, petitioner contends that the estate should be permitted a deduction in the amount of $13,143.96, the amount by which the settlement payment exceeded the actual expenses and value of property Ms. McDavid claimed as a beneficiary.

Respondent claims that the amount paid in settlement of Ms. McDavid's lawsuit is not deductible because the amount was not an "administration expense" within the meaning of section 2053(a)(2) because the payment was made in settlement of a trust beneficiary's claim, not in settlement of a debt owed for a deductible expense incurred by the estate. For the reasons below we agree with respondent.

In determining the value of the taxable estate, expenses of administration, as are allowable by the laws of the jurisdiction under which the estate is being administered, are deductible from the value of the gross estate. Sec. 2053(a)(2). Respondent's regulations provide that amounts deductible as "administration expenses" are:

> limited to such expenses as are actually and necessarily incurred in the administration of the decedent's estate; that is, in the collection of assets, payment of debts, and distribution

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9. (continued)

share is not deductible from the gross estate for estate tax purposes. *Pennsylvania Bank and Trust Co. v. United States*, 597 F.2d 382 (3d Cir. 1979); *Estate of Lazar v. Commissioner*, 58 T.C. 543 (1972); *Estate of Alden v. Commissioner*, T.C. Memo. 1982-183. Here, petitioner refers to Ms. McDavid as a "creditor" to distinguish her from a "beneficiary" when arguing that the amount paid in the settlement was an expense of administration under section 2053(a)(2).

> of property to the persons entitled to it. The expenses contemplated in the law are such only as attend the settlement of an estate and the transfer of the property of the estate to individual beneficiaries or to a trustee, whether the trustee is the executor or some other person. Expenditures not essential to the proper settlement of the estate, but incurred for the individual benefit of the heirs, legatees, or devisees, may not be taken as deductions. * * * [Sec. 20.2053-3(a), Estate Tax Regs.]

Furthermore,

> Miscellaneous administration expenses include such expenses as court costs, surrogates' fees, accountants' fees, appraisers' fees, clerk hire, etc. Expenses necessarily incurred in preserving and distributing the estate are deductible, including the cost of storing or maintaining property of the estate, if it is impossible to effect immediate distribution to the beneficiaries. Expenses for preserving and caring for the property may not include outlays for additions or improvements; nor will such expenses be allowed for a longer period than the executor is reasonably required to retain the property. [Sec. 20.2053-3(d)(1), Estate Tax Regs.]

The amount paid in settlement of Ms. McDavid's claim does not fall within the statute or these regulations. Ms. McDavid brought her lawsuit to recover amounts which were payable pursuant to the terms of the testamentary trust established by decedent. That trust was comprised of the

residue of decedent's estate which, including the house in which Ms. McDavid was to reside, was transferred to Mr. Keifer, as trustee. We recognize that as co-executor of the estate and trustee of the testamentary trust, Mr. Keifer served separate functions settling and administering decedent's estate and the testamentary trust. However, by naming Mr. Keifer as defendant in both capacities, Ms. McDavid did not change the nature of her claim, which was the recovery of amounts which were payable pursuant to terms of the trust. The carrying on of a trust is a different enterprise from the settlement of an estate, *Sharpe's Estate v. Commissioner*, 148 F.2d 179, 181 (3d Cir. 1945), and expenses incurred by a testamentary trust, once property is passed through decedent's estate to the trust, are incurred due to the operation of the trust and are properly deductible by it only. *Estate of Streeter v. Commissioner*, 491 F.2d 375, 378-379 (3d Cir. 1974). Here, the expense of repairing Dr. Bograd's house was an expense of the trust, not an expense of administration of the estate.[10]

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10. In order to be deductible as an expense of administration, it is necessary that the deduction be an administration expense within the meaning of the statute and be allowable under state law. *Marcus v. DeWitt*, 704 F.2d 1227 (11th Cir. 1983); *Hibernia Bank v. United States*, 581 F.2d 741, 744-745 (9th Cir. 1978); *Pitner v. United States*, 388 F.2d 651 (5th Cir. 1967); and see *Estate of Papson v. Commissioner*, 73 T.C. 290, 299 n. 9 (1979), (for discussion of the conflict in the courts with respect to this dual requirement). Because we have determined that the amounts paid were not expenses of administration, we have not addressed whether they would be allowable under state law.

We also note that petitioner's reliance on *Central Trust Co. of Cincinnati, Ohio v. Welch*, 304 F.2d 923 (6th Cir. 1962), is misplaced. In that case decedent had created an inter vivos trust, placing substantially all her property in the trust, net income of which was payable to her daughter. When decedent died the daughter sued to set aside the trust. The estate claimed a deduction for expenses of the trustee

Furthermore, any additional amounts paid, above the actual cost of the repairs, were also paid as a result of the trust beneficiary's claim under the terms of the trust. Thus, Ms. McDavid's claim for damages does not transform that portion of her recovery which was in excess of the amount incurred for repairs into an expense of administration. The amount had nothing to do with the settlement of the estate or the disposition of the property of the estate. Moreover the $20,000 note which Ms. McDavid was permitted to keep was not specifically bequeathed otherwise and would have been a part of the residue from which the trust was comprised. While the distribution in settlement of her claim may affect the income tax consequences of the estate or the trust, it does not affect the estate tax consequences and does not reduce the taxable estate.

To reflect the foregoing,

Decision will be entered

under Rule 155.

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10. (continued)

paid in connection with the defense of the daughter's claims. The deduction was allowed as an expense of administration of the estate because the defense of the suit against the trust was necessary to determine what property was to be included in the estate. The property in the trust would have become part of the estate if the trust was set aside. Otherwise it passed outside the estate. Here the defense of Ms. McDavid's claim was not necessary to determine what was to be included in the estate. Her suit pertained to and affected the trust only.

APPENDIX E

UNITED STATES TAX COURT

Docket No. 4417-85

ESTATE OF NATHAN BOGRAD, DECEASED,
J.B. KIEFER, EXECUTOR,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ADM.
RECORDED
s/s Bam
SERVICE
s/s Bam
CAL. s/s Bam
✓ STAT. *(illegible)*
JUDGE
s/s Whitaker
✓ FILES
(stamp)

DECISION

Pursuant to the opinion of the Court filed February 1, 1988, and incorporating herein the facts recited in the respondent's computation as the findings of the Court, it is

ORDERED and DECIDED: That here is a deficiency in estate tax due from the petitioner in the amount of $89.-982.88.

s/s *(illegible)* Whitaker
Judge.

Entered: **JUN 22 1988**
(stamp)

SERVED JUN 28 1988
(stamp)

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

It is further stipulated that the petitioner may claim a credit for State estate, inheritance, legacy or succession taxes and may present to the Internal Revenue Service proof of such payment within the statutory period.

WILLIAM F. NELSON
Chief Counsel
Internal Revenue Service

By: s/s Louis John Zeller, Jr.
LOUIS JOHN ZELLER, JR.
Assistant District Counsel
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New Orleans, Louisiana 70190
Tel. No. (504) 589-2888

JUN 15 1988
(Date)
(stamp)

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